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News and Views from the Pinsent Masons Tax team

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The tax assurance commissioner's first annual report

by Jason Collins

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The post of tax assurance commissioner (TAC) was created in February 2012 and assumed by Edward Troup in August 2012. He has published an annual report covering the work done in his first fiscal year. The report provides a commentary on how HMRC handles disputes across the whole organisation, and examines the exercise of new governance arrangements in place for resolving larger disputes. It also discusses a pilot review of a sample of settled cases across a range of HMRC's work and highlights the operational success HMRC has had in litigation.

Background

It is worth casting minds back to the reason for the creation of the post of TAC. In 2011, HMRC faced a barrage of criticism from the National Audit Office (NAO) and the Public Accounts Committee, in response to alleged reports of 'sweetheart' deals with companies such as Vodafone and Goldman Sachs. The settlements were ultimately found to be reasonable value, but HMRC was criticised for having 'specific and systemic' governance failures. Earlier this year, a High Court judge described the settlement with Goldman Sachs, which included a significant technical mistake, as 'not a glorious episode in the history of the Revenue'.

HMRC did not accept all the criticisms, but recognised that it needed to restore public trust. The post of TAC was created to oversee HMRC's overall dispute handling processes. The TAC continues to hold that line in the report which, although it adopts an open tone, is very protective of the work done by HMRC – as might be expected given the TAC is (for many, controversially) not independent from"HMRC.

Governance for large corporates

The new governance arrangements included the creation of the Tax Disputes Resolution Board (TDRB), to consider proposed settlements in cases where the total tax under consideration is more than £100m, or where the case is sensitive or could have a significant impact on HMRC's policy, strategy or operations. It also considers a sample of cases where the total tax under consideration is in the range of £10m to £100m. The High Risk Corporates Programme Board was folded into the TDRB.

The TDRB does not involve itself in the specific negotiations with an affected corporate. It looks at proposals for settlement put forward by case teams (who attend the TDRB meetings) and makes recommendations to three HMRC commissioners, including the TAC, who have the final say on whether a proposed settlement should proceed.

Beneath the TDRB are other HMRC governance boards, covering enforcement and compliance, personal tax, business tax and transfer pricing. These bodies make decisions on settling smaller cases and are responsible for ensuring that sample cases are referred to the TDRB.

Cases considered by the commissioners

According to the report, the TDRB handled 31 cases during the period covered by the report, of which 22 were referred to the commissioners. In 16 of the 22 cases, the TDRB endorsed the settlement proposed by the taxpayer; in five cases it recommended rejection; and in the remaining case,

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the TDRB could not agree so referred it without any recommendation.

The report then details that the commissioners decided that in 11 of the 22 cases referred (worth £1,368m) the proposed settlement was acceptable. The commissioners rejected the taxpayers' proposed settlements in five cases (worth £398m); and in another six cases (worth £285m), the taxpayers' proposals were accepted but with additional conditions.

The report becomes a little muddled here. It is not clear whether the five cases referred by the TDRB with a recommendation that the taxpayers' proposals be rejected were the same five cases where the commissioners rejected the taxpayers' proposals – but one has to assume that must be the case.

The report is also not clear whether, in the six settlements where additional conditions were imposed, the conditions were suggested by the commissioners, in which case it would suggest that the commissioners were not satisfied with the recommendations of the TDRB in a quarter of the referrals. However, I am informed by HMRC that, although the report does not say this, the conditions may in fact have been suggested by the TDRB. Hopefully, this will be clarified in future reports.

Sample cases

As noted, the TDRB and commissioners will review settlement proposals for a sample of cases with between £10m and £100m at stake. Of the 31 referrals to the TDRB (and 22 referrals to the commissioners), only one was a sample case. This came from the Enforcement and Compliance Board, and further samples from this Board are in the pipeline. There were no personal tax cases of more than £10m from which to pick in 2012/13. It is expected that there will only be between six and 12 such cases in 2013/14, and the report says that all of these cases are expected to be selected as samples.

Internal reviews

Annex 2 provides statistics on the outcome of formal internal reviews of HMRC decisions. In 2011/12 (the latest year for which statistics are currently available), HMRC carried out approximately 56,000 reviews. In non-penalty cases and non-VAT penalty cases, 24% of HMRC's decisions were cancelled. However, in relation to VAT penalties, where over 30,000 cases went to review, a whopping 60% of HMRC's decisions were cancelled.

Taxpayers also have a right of appeal to the tax tribunal, in addition to a right of review. Appendix 2 notes that HMRC succeeded in 61% of appeals and lost 32%. Taken together with the average figures for all decisions overturned on review (50%), HMRC appears on average to be getting it right in only 30% of its decisions.

Larger cases

Where HMRC is having better operational success is in relation to the litigation of larger cases. The report includes a table showing the current state of play in cases before the Court of Appeal, Court of Session and Supreme Court. These figures reveal that 14 out of 22 cases were decided in HMRC's favour, with only six against, and two judgments still awaited. Some of these results represent the final conclusion of the litigation, but in the majority of cases the losing party is appealing.

In avoidance cases, across the tribunals as well as the higher courts, the success rate was even better, with HMRC winning in 27 out of 33 cases – which HMRC claims protected £1bn of tax. Across all its litigation, HMRC says that judgments in HMRC's favour protected in the region of £10.89bn. Judgments against HMRC totalled £663m, but the report states that 'many of these are under appeal and we are confident of success'.

And finally … the LSS

All cases settled by the commissioners were apparently settled in accordance with the terms of the litigation and settlement strategy (LSS) – namely, no 'splitting the difference' and no 'package settlements' (i.e. where there is more than one dispute between the taxpayer and HMRC, each issue must be considered on its individual merits). However, HMRC makes an interesting admission. The NAO analysis of five specific settlements with large corporates, including Vodafone and Goldman Sachs, found that while each settlement represented good value for the exchequer, one settlement was not necessarily in line with the LSS. The settlement was a multi-issue case and there was evidence that HMRC gave away what was a good issue in order to secure cost-effective agreement across the other issues. HMRC now appears to accept that such an outcome – although rare – is consistent with the LSS, and it plans to update the LSS guidance to repect this.

Interestingly, the report includes some anonymised case studies 'drawn from experience in actual cases'. From

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these, it may be possible to discern that, in multi-issue cases, HMRC may be more willing to concede 'technical' issues in order to win the 'avoidance' ones – provided the technical dispute does not have substantial read across effect for other taxpayers.

However it is dressed up, the 'exceptional' flexing of the LSS in multi-issue cases is merciful recognition of the practicality of dispute resolution pressures. Sometimes, one just needs to give some ground to get a reasonable settlement. Nevertheless, this example of litigation expediency must surely undermine the 'purity' of the approach taken in the LSS. So why should litigation expediency be limited just to multi-issue cases?

HMRC appears to have lost sight of the original reason for the LSS – namely, to stop the practice of the parties 'splitting the difference' between them on merits in order to settle the dispute, a practice which HMRC said was encouraging taxpayers to take up the next avoidance scheme available. Given the continuing scale of the avoidance problem since the LSS was launched six years ago, the validity of that theory has to be seen to be in doubt. It remains puzzling to many practitioners that HMRC cannot see that the wheels would not come off the cart, if it were to cite expediency as a ground to offer generous settlement terms to deal with the huge backlog of current litigation cases.

The LSS was also designed to make sure that individuals within HMRC could not ride roughshod over colleagues in order to get to a deal. But this culture was a reflection of the then leadership of HMRC and, with the new governance around how HMRC settles disputes, HMRC has less of a need for an indomitable LSS. It should really now be thinking about rowing back. As it stands, it continues to paint itself into a corner, trumpeting that its approach has 'secured' an extra £1bn in backlog cases – yet at the same time, estimating that £5bn of new avoidance risk is added to the tax gap each year. Surely there has to be a more productive way to collect in that potential additional tax, even if it is only a decent proportion. ●

Raising the stakes on tax avoidance

by Heather Self and Ray McCann

This comment on the Raising the stakes on tax avoidance consultation document was first published in Tax Journal on 30 August 2013

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In October 2005, Dave Hartnett, then HMRC permanent secretary, said that HMRC's aim was to stamp out avoidance by 2008. Looking back at articles written by Mr Hartnett at the time, he also revealed his frustration that advisers were not accepting that the decision of the House of Lords in MacDonald v Dextra Accessories Ltd [2005] UKHL 47 meant many employee benefit trust (EBT) schemes failed, and that taxpayers should now pay the tax HMRC asserted was due.

HMRC's battle against EBTs and tax avoidance in general has been a long one. The disclosure of tax avoidance schemes (DOTAS) regime introduced in March 2004 was a significant step forward in enabling HMRC to spot schemes more quickly and close them down (sometimes very rapidly). This was followed by HMRC's litigation and settlement strategy (LSS) in 2007, signalling a move to tackle avoidance at source, rather than chase down individual taxpayers one by one. In 2013, the general anti-abuse rule (GAAR) became law, and taken together with the fact that HMRC would seem to be winning all of the tribunal and court tax avoidance cases (with a few notable exceptions), the future for aggressive or abusive tax schemes looks bleak. Attitudes to avoidance have also shifted, especially in the time of austerity since the financial crisis in 2008, and the significantly increased risk of reputational damage through being 'named and shamed' – often by politicians and the media – has made many large corporates wary (as well as deeply frustrated that such simple actions as claiming capital allowances are perceived as not paying their 'fair share'). The 'big four' are rumoured to have scaled down their 'product teams' and a number of medium-sized firms have also scaled back on their tax planning activities.

It is hard to believe that current activity levels of aggressive or abusive tax schemes are high enough to justify further cluttering the UK tax code with more legislation

However, in HMRC's view, there are still pockets of resistance, with some promoters and their clients still seemingly willing to 'take a punt', on the basis that 'if a scheme is "legal" and supported by a strong counsel's opinion, then why not?' Realistically, such situations have become less common, and it is worrying that HMRC is still bringing forward proposals to radically alter the balance of power between taxpayers and the tax authority, for example, both in this consultation and that published recently in relation to banks It is hard to believe that current activity levels of aggressive or abusive tax schemes are high enough to justify further cluttering the UK tax code with more legislation, which may in the end be largely unused with few targets to aim at. However, the concern will be that, as with the GAAR, what these rules are supposed to target and what they actually do target may be quite different.

The bigger concern remains HMRC's seeming inability to make a meaningful reduction in the enormous backlog of unsettled tax schemes. This has been

Raising the stakes on tax avoidance *(continued)*

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estimated at some 41,000 cases, with film and other partnerships and EBTs making up half of this, and it is no coincidence that special settlement facilities are running for such schemes. Lack of resource on HMRC's part may be part of the problem, but the complexity of the LSS-based approach and HMRC's determination to gather every possible piece of information on a scheme has made delay, sometimes lasting years, inevitable. So the current consultation proposes legislative changes that take a different approach on three key areas:

- a targeted attack on 'high-risk promoters' of tax avoidance schemes;
- significant new penalties for failure to comply with the new information regime; and
- penalties for failing to settle once a similar scheme has failed in the courts.

It is the last of these measures which could prove to be controversial and potentially significant for tax litigation in the UK, and perhaps a time bomb for schemes currently under enquiry.

High-risk promoters

HMRC believes there is a relatively small group of 'boutique' promoters, perhaps 20, that persist in selling avoidance schemes. If HMRC is correct, these schemes are badly planned, have little or no chance of success, are hidden from HMRC, and rely upon non-cooperation with HMRC to have any chance of achieving their intended tax outcomes. If this sort of behaviour was common, HMRC would have every right to propose the strongest possible measures to combat such behaviour and reputable advisers would fully support them. But what evidence suggests that, despite everything, this problem persists in a way that justifies legislative changes of the sort proposed?

> *HMRC suggests that it will take 'an overall view of the promoter's business'. Sadly, that sounds very like a random 'stop and search' programme*

A degree of tact is needed on HMRC's part to identify high-risk promoters, while not alienating the great majority of 'responsible' tax advisers. Some years ago, a joint project between HMRC and the professional bodies had the loose title of 'poor work by accountants', which caused apoplexy among senior members of the profession when this was displayed on a meeting room notice at ICAEW HQ. HMRC has also struggled to remove an air of suspicion that has hung over the agent strategy, which is slowly beginning to dissipate under 'new management'.

HMRC struggles to define a high-risk promoter by reference to objective criteria. As it points out in the consultation, a promoter that sells schemes and does not disclose them, and refuses to discuss the basis for non-disclosure, is probably much higher risk than one that engages with HMRC but occasionally makes a late disclosure: there is a danger that HMRC labels visible behaviour as 'high risk', while ignoring that which is more difficult to detect.

Instead, HMRC suggests that it will take 'an overall view of the promoter's business'. Sadly, that sounds very like a random 'stop and search' programme, and is likely to be just as unpopular. Publicly designating a promoter as 'high risk' puts the promoter's livelihood into severe jeopardy and lays HMRC open to judicial review proceedings.

The proposed process would move from informal discussions, via a voluntary undertaking, to formal designation. There would then be an appeal process, and it seems likely that the appeal would have to take place before designation could become effective. It all feels like a lot of bureaucracy, probably taking several months, and could leave HMRC open to criticism of unfairness without the most stringent internal safeguards.

Information powers and sanctions

HMRC proposes new information requirements in relation to the high-risk promoter regime, with initial penalties for non-compliance of up to £1m and daily penalties of £10,000.

The DOTAS information requirements will also be amended, so that HMRC would in effect receive the same information as the promoter provided to the client, with further disclosure to HMRC if the planning is changed. This will require significantly more detail to be provided to HMRC, and will apply to any scheme notification whether from a 'high-risk' promoter or not.

Users of 'failed' schemes

At a practical level, the proposal to introduce a penalty on users of failed schemes is potentially the most far-reaching. A brief review of recent

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tribunal decisions shows that HMRC's batting average is high, as it has won almost all of the more important tax avoidance cases in recent years – although there have been a few notable exceptions.

Conceptually, the new proposal is breathtakingly simple. When HMRC wins a case, and the decision is final, it will write to all those with open enquiries inviting them to reconsider their position. Those that choose to fight on will do so in the clear knowledge that they are facing a much more significant downside, in the form of a penalty – perhaps as much as 50% for lack of reasonable excuse if they lose. As matters stand, it seems that HMRC would look to rely upon decisions of the courts prior to the new rules becoming law, so the clock may be ticking on existing schemes that have not yet settled. Thus, like Banquo's ghost, Mr Hartnett may be gone but it appears he is not forgotten; and using the long-running dispute over EBTs as an example, HMRC would be able to ask a taxpayer that had used a *Dextra*-type EBT to explain why they were still persisting with their appeal, or to agree that the tax should now be paid. If in the face of this the taxpayer persists, a penalty would be charged in the event that the appeal ultimately fails.

At a practical level, it may be less straightforward, but in this way HMRC would hope to counteract the mills of justice, which inevitably turn slowly due to the weight of cases. Currently, around 10,000 cases are listed for the FTT each year, but only around 5,000 are settled, so there is a real need to find a way to finally make significant inroads on the 41,000 outstanding scheme disputes.

However, recent experience of HMRC's standard letters (for example, to some 600 *Mansworth v Jelley* cases) shows that HMRC will get it wrong in a number of cases. We have seen attempts to enforce assessments for years which have been formally closed, and even attempts to open enquiries well outside the relevant time limits. There is some element of HMRC's needing to get its own house in order, but assuming it can do so, with these new proposals those still playing the 'game' may be finally bowled out

The consultation document can be found at https://www.gov.uk/government/consultations/raising-the-stakes-on-tax-avoidance.

Loop-the-loop—has Pendragon helped define what amounts to abusive VAT structuring?

an interview with Suzanne McMahon

This comment was first published on LexisNexis on 6 August 2013

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Revenue and Customs Commissioners v Pendragon PLC and others [2013] EWCA Civ 868, [2013] All ER (D) 278 (Jul)

The Court of Appeal, Civil Division, decided the Upper Tribunal (Tax and Chancery Chamber) had not been entitled to interfere with the determination of the First-tier Tribunal (Tax and Chancery Chamber) in a dispute about value added tax in circumstances where it could not be shown that the First-tier Tribunal had erred in law.

What is the background to this case?

The appeal concerns whether a funding arrangement for demonstrator cars involving an offshore bank, which resulted in the taxpayer accounting for VAT under the margin scheme for second hand goods, was abusive.

The purpose of the arrangements involving the parties was to acquire demonstrator cars for the taxpayer's car dealership business in a VAT-efficient manner. The arrangements involved:

- Pendragon selling new cars to four of the captive leasing companies—these cars were used as demonstrator cars before then being sold to ordinary customers
- the captive leasing companies leasing the cars simultaneously to Pendragon's dealerships
- the captive leasing companies assigning the lease agreements and title in the cars to the offshore bank, and
- a month or so later, the offshore bank transferring the lease agreements and title in the cars as a transfer of a going concern (ie VAT free) to the fifth captive company, which sells the cars to customers—with the dealerships acting as its undisclosed agents

In terms of VAT, the sale by Pendragon is a taxable supply. Pendragon charges VAT on the cars to the captive companies and recovers input tax on purchase of the cars. The leases onwards are taxable services. No title passes at this stage as per the Value Added Tax Act 1994, Sch 4, para 1(2)(b). Each captive then recovers VAT charged to it by Pendragon and accounts for VAT on lease payments received from the dealers.

The dealerships recover VAT incurred as attributable to its taxable dealership activity. The assignment to the bank is not a supply as it constitutes an assignment to a bank by the owner of goods subject to a lease agreement under the Value Added Tax (Special Provisions Order) 1995, SI 1995/1268, art 5(4). The sale by the offshore bank to the fifth company of the leasing business is outside the scope of VAT as a transfer of a going concern (TOGC).

The onward sale of the vehicles to the customers falls under the margin scheme for second hand cars. Therefore, VAT is only accounted for on the margin between the sale proceeds and the cost of acquisition. On these facts, the fifth company only accounts for VAT on the difference between the cost of the car on its purchase from the offshore bank and the sale price.

Loop-the-loop—has Pendragon helped define what amounts to abusive VAT structuring? (continued)

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What was the ultimate result of this loop?

All VAT previously charged in the chain of supply was fully recoverable. The net VAT due to HMRC, once the arrangement had run its course, was the VAT on the margin on the final sale.

What were the arguments and how was the principle in *Halifax plc v Customs and Excise Commissioners*: C-255/02 [2006] STC 919 applied?

HMRC argued the arrangements gave rise to a tax advantage which was contrary to the purpose of Council Dir 2006/112/EC (the VAT Directive), and that the structuring of the transactions was solely to gain a tax advantage. It claimed the two legs of *Halifax* abuse criteria were satisfied, and therefore the arrangements should be re-characterised to put the parties in the position that would exist without the arrangements.

Pendragon focused its position on the interaction of the UK's transfer of a business as a going concern and margin scheme provisions, and maintained financing had been the essential aim of the arrangements, which demonstrated Pendragon needed to arrange funding for good commercial reasons. It took the stance that it was possible to have tax-efficiency as a motive without being abusive.

On what basis was the Court of Appeal able to overrule the decision of the Upper Tribunal and what did it decide?

The Upper Tribunal was satisfied the outcome of the arrangements was contrary to the purpose of the VAT Directive, as the tax advantage which had accrued was, in fact, distortive, as Pendragon would be able to account for less VAT than a competitor. The Upper Tribunal said it was clear Pendragon had used the national provisions in order to obtain a tax advantage which was contrary to the VAT Directive and the tax advantage was the essential aim. Consequently, the arrangements were abusive and should be redefined—and it preferred HMRC's redefinition.

The Court of Appeal considered the well-known ECJ abuse cases (*Halifax: C-255/02* [2006] STC 919, *Ministero dell'Economia e delle Finanze v Part Service Srl:C-425/06*[2008] STC 3132; *Revenue and Customs Commissioners v Weald Leasing Ltd: C-103/09*[2011] STC 596; and R*BS Revenue and Customs Commissioners v RBS Deutschland Holdings GmbH:C-277/09* [2011] STC 345) and handed down a definitive decision that will be welcomed across the industry for the further clarification of the case law on the abuse of rights principles in VAT. From these cases, it is clear objective factors have to be considered to ascertain whether transactions (or a series of transactions) have an alternative commercial explanation, other than the attainment of a tax advantage as its essential (or principal—as per *Part Service*).

If this can be established, the principles that prohibit abusive practice cannot apply. In following this approach, the court accepted counsel for the taxpayer's submission that this search for establishing whether a series of transactions had an economic explanation beyond securing a tax advantage had to 'go beyond the abstract of formal analysis' and look for an economic purpose, ie a precise way that performance of the contractual set up satisfies the interests of all parties.

The court accepted the taxpayer's arguments that, although a tax advantage can be taken as read, a court's role is to focus on whether sufficient other explanations exist for a particular structure. This includes detailed examination of contracts, whether parties are at arm's length, finance arrangements and levels of consideration between parties.

Crucially, the court ruled the Upper Tribunal's characterisation of the transactional structure utilised by the Pendragon group was artificial and devoid of commercial purposes, and 'an assertion unsupported by any reasoning or analysis'. It went on to say that the Upper Tribunal had made 'no attempt' to address the reasons why the taxpayer would choose to set up a hire-purchase arrangement before assigning cars to an offshore bank under a security, or why it would use a company in the group other than the one that bought the cars in the first place. It failed to see that there may have been perfectly valid 'reasonable and normal commercial practice' underlying the arrangements, and therefore the Upper Tribunal was wrong and the taxpayer's appeal should be allowed.

Should taxpayers now be concerned about HMRC challenges when they have followed VAT structuring advice from tax advisors?

This will certainly not be the end of similar cases. As businesses seek to maximise income, there is always a drive to find savings in one way or another.

Loop-the-loop—has Pendragon helped define what amounts to abusive VAT structuring? (continued)

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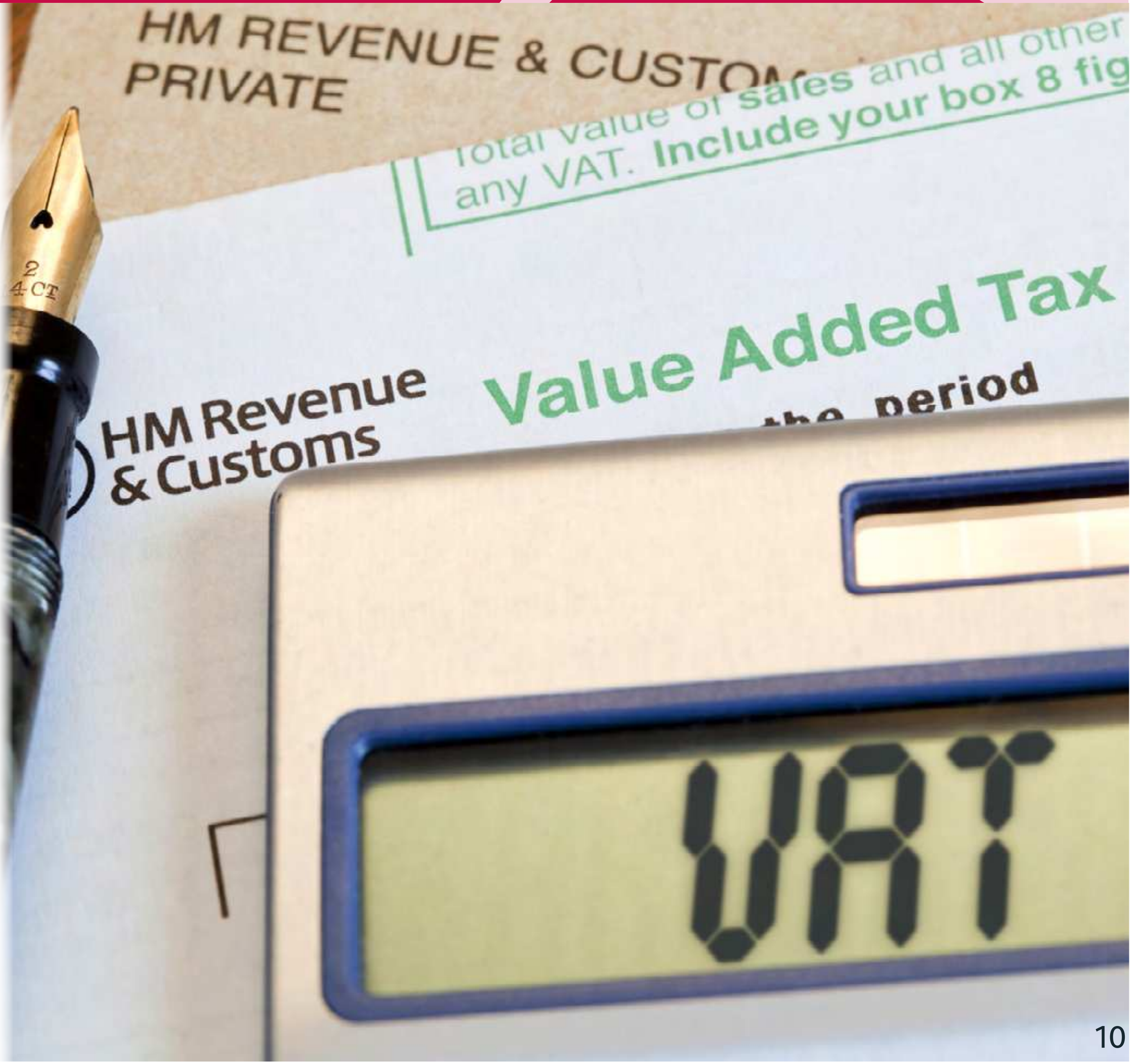
This case seems to suggest that legitimately justified commercial arrangements that have business-based advantages as the object, purpose and effect cannot always be struck down as purely artificial just because a tax advantage is derived.

However, the decision does urge courts to apply a detailed consideration and analysis of all the factors in determining whether arrangements are contrary to the spirit and purposes of EU VAT law and principles. If this consistently becomes the norm, HMRC may be more cautious about attacking genuine and real commercial arrangements with true economic justification as abusive, just because there is a tax benefit arising.

Suzanne McMahon was interviewed by Nicola Laver.



University of Cambridge v HMRC – input tax recovery for non-business activities

by Darren Mellor- Clark

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The University of Cambridge has won a first tier tribunal case regarding input tax recovery in relation to non business activities.

Background

The case concerned VAT incurred on management and other professional fees incurred in relation to the Cambridge University Endowment Fund (the fund). Cambridge University (the university) receives donations which it invests in the fund; the fund itself invests those donations in a range of investments including equities, bonds, property and cash deposits. The fund produces around £40m of income per year, out of a total income for the University of £1.26bn. The income is distributed across the University in support of all of its activities, and comprises around 6% of the University's operational expenditure.

In 2002 the University submitted a claim for input tax in relation to the management fees. HMRC rejected this claim, citing the *NSPCC* case (VTD 9325). The University did not seek to challenge or appeal this rejection. Following the *Fleming* decision the University submitted a claim for residual input tax for the longer Fleming period. The University indicated that the *NSPCC* decision was not relevant as in *NSPCC* the appellant sought to establish that the investment activities were economic activities for VAT purposes. Whereas, in the current case, the University accepted that the fund did not undertake economic activities, but that the fund's activities entirely supported the University's operation. On that basis they represented overhead costs of the University which should be recovered as a residual item in the University's partial exemption special method .

It was common agreed ground between the parties that the operation of the fund is not an economic activity and is therefore outside the scope of VAT.

The issues

Counsel for the University relied primarily on the definition of overhead expenditure from *Mayflower Theatre Trust v HMRC* and the ECJ decisions in *Kretztechnik*; *Securenta*; and *AB SKF*.

Mayflower defined residual input tax as being input tax which is either: a) attributable to both taxable and exempt supplies; or b) not linked to either, the latter being frequently referred to as "overheads". In relation to category b, deduction depends establishing an appropriate link with the "whole economic activity" of the taxable person.

Counsel argued that all that was necessary for the University to prove was that, on an objective basis, the activities of the fund were undertaken solely to support the economic activities (both taxable and exempt) of the University as a whole. If this may be established, then there is a sufficient direct and immediate link with economic activities as a whole. On which basis the input tax should be taken to be overhead expense of the University, and thus available for residual recovery via the University's partial exemption method.

HMRC argued that *Kretztechnic* and *Securenta* are not relevant here as they both concerned transactions which were not a supply for VAT purposes - ie the issue of shares or similar equity ownership for the

University of Cambridge v HMRC – input tax recovery for non-business activities (continued)

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purposes of raising capital. In the present case the fund undertook transactions that were capable of being supplies, the selling of various securities etc, albeit that they were not undertaken by a taxable person acting as such. Despite the mutually agreed position that the fund did not undertake economic activities for VAT purposes, HMRC argued that the activities were not a nullity and could not be simply ignored for deduction purposes. Instead, the fund conducts a "freestanding activity" of its own. This activity is not a pre-cursor to the University's performance of its economic activities and so costs of its investment activities may not be reattributed to its economic activities.

Futher, HRMC argued that in *Securenta* the ECJ had ruled that such costs must be solely attributable to the economic activities of the taxable person to justify treatments as overheads. In the present case the investment costs burdened only the non-economic activities of the University - ie the disposal of securities etc. Although the income generated may subsidise the economic activities, this is not the same as the costs forming a direct price component those activities. In which case, treatment as residual input VAT of the economic activities is not available.

The decision

The Tribunal rejected HMRC's position and ruled that the costs could be treated as residual by the University.

In particular the Tribunal rejected the notion that the fund's activities stood between economic and non-economic activities as a "freestanding activity" and thus acted as a chain breaker in any link to the University's activities as a whole. The mutually agreed position that the fund did not undertake economic activities had the natural effect of meaning that they should be disregarded for deduction purposes.

It was noted that in *Securenta* the ECJ had observed that some of the costs in question were, in part, for the performance non-economic activities. The Tribunal ruled that if the management costs were incurred for non-economic activities, that was not fatal to the treatment as residual, provided that there is methodology to attribute such costs to the University's economic activities.

The Tribunal particularly noted the judgement of Blackburne J in *Church of England Children's Society*: "*...as Kretztechnic made clear, whilst it is established that the transaction with which the fundraising services are most directly and immediately linked is not a supply at all that link is irrelevant for the purpose of determining deductibility.*" In the Tribunal's view, the clear conclusion from this is that if the non economic activity funds economic activities of the taxable person, then costs should be deducted as residual.

It was clear to the Tribunal that the activities of the fund were undertaken solely to support the economic activities of the University and as such residual recovery should be available. It was not necessary for the University to prove that the management costs burdened *only* its economic activities.

Implications

It is expected that HMRC will appeal this decision, however the principle established is interesting. Against the changing backdrop of education provision in the UK, in particular the increased commercial pressures facing providers and students, it is probably inevitable that scrutiny of all aspects of funding models will increase. Similar education providers would be wise to consider their own positions following this decision, in particular whether it is prudent to submit "protective" claims in the light of HMRC's likely appeal.

The extension of this principle to businesses outside of the Universities sector is obviously an inevitable further step for consideration. A question springing to mind is to what extent the conclusion that the activities of the fund solely benefited the University was supported by the restrictions imposed by the charitable status of the University.

At a general level the extensive discussion of the concept of "price component" of an output to justify input tax recovery continues to cause difficulties. This is especially so when one is dealing with securities and other investments where the price is determined by the market rather than the cost base of the seller. Similarly the introduction of a third category of "freestanding activity" standing somewhere between economic and non-economic activities would further confuse an already painful deduction landscape.

M&A – Buying a Company with EFRBS/EBT planning

by Jon Robinson and Chris Thomas

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With HMRC increasing its efforts in challenging tax avoidance schemes, many companies that have undertaken remuneration planning involving employee benefit trusts (EBTs) and employer-ennanced retirement benefit schemes (EFRBS) now find themselves subject to enquiries. Whilst HMRC will be principally challenging the alleged underpayment (or non-payment) of PAYE and NIC in respect of historic steps under such planning, this is not the whole story as there now also exists the threat of disguised remuneration charges under ITEPA 2003 Part 7A on any 'relevant steps' taken in relation to the arrangements.

HMRC's dislike of trust-based remuneration planning is clear. In November 2009, anti avoidance 'spotlight' number 5 was published, in which HMRC proclaimed that 'companies have been seeking to reward employees without operating PAYE/NIC by making payments through trusts and other intermediaries that favour the employees or their families ... *HMRC's view is that at the time the funds are allocated to the employee or his/her beneficiaries, those funds become earnings on which PAYE and NICs are due and should be accounted for by the employer' (HMRC's emphasis).* This was followed by spotlight 11 (March 2011), in which HMRC stated that planning involving loan repayments aimed at sheltering funds from the impact of the (then) full implementation of the disguised remuneration rules was also considered ineffective. Now we have the EBT settlement opportunity, under which HMRC invites taxpayers to agree with its views on the effectiveness of trust-based planning and settle PAYE and NIC liabilities (see 'EBT settlements in practice' (James Hume & Steve Edge), Tax Journal, dated 25 January 2013).

The aim of this article is not to examine the technical merits of trust-based remuneration planning, nor to comment on the steps that HMRC is taking to challenge it and resolve outstanding cases under the EBT settlement opportunity. Rather, this article considers the issues that need to be considered in an M&A context, where a buyer is seeking to acquire a target company that is the subject of a HMRC enquiry covering this type of planning. This may sound like a fairly unusual combination of events (i.e. undergoing a change of control whilst subject to a HMRC enquiry into remuneration planning). However, the authors have advised on several such transactions in the last 12 months alone. Factors that may have contributed to this include:

- remuneration planning was heavily 'sold' to companies in the years before the introduction of the disguised remuneration rules and before HMRC's sharp focus on EBT planning;
- most companies that have been challenged are still in the process of taking advice, monitoring the progress of HMRC's strategy in this area and considering options under the EBT settlement opportunity, therefore not many cases have already been fully resolved with HMRC; and

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- whilst some distance short of a full recovery, there has been a general upturn in M&A activity, particularly at the mid to lower end of the market, involving the sort of target companies at which promoters of remuneration planning will have aimed, with buyers keen to drive revenue growth through affordable acquisitions.

Trust-based remuneration planning: the basic principles

Whilst all cases will be different on their facts, and there are various more or less complicated versions of trust-based remuneration planning, at a simple level for the purposes of an example, the tax planning that is likely to be subject to HMRC challenge may look broadly as follows:

- the target would establish an EBT (or EFRBS) with a trustee and make contributions to it;
- the EBT would establish sub-trusts for the benefit of particular employees of the target (and their families), and appoint the contributions onto the various sub-trusts;
- when undertaken, neither of the above steps would be regarded by the target as giving rise to obligations to account for PAYE or NICs;
- the amounts held on the sub-trusts would be loaned to the relevant employees with a very low resulting employment income tax charge (being the tax payable on the beneficial loan under ITEPA 2003 Part 3 Chapter 7 assuming the loan is interest-free); and
- whilst technically repayable, the loan would most likely in fact never be repaid, in which case the target may have been advised that no income tax charge (over and above the beneficial loan charge) would arise, provided the loan was only waived following the eventual death of the employee (and that this would also carry an inheritance tax advantage, in that the relevant sums would fall outside the deceased's estate).

Of course the position on corporation tax relief for the employing company must not be forgotten. Whilst in the past some companies tried to 'have their cake and eat it' by claiming corporation tax relief for contributions to EBTs, typically that position has been challenged and reversed, and the rules in this area (CTA 2009 Part 20) are now clear – relief is only available as and when 'qualifying' (i.e. taxable) benefits are provided out of the trust.

Buying a company that is subject to HMRC challenge

The first thing a buyer would want to do upon becoming aware that the target has implemented this type of planning is to find out as much as possible about the historic arrangements and the current status of any HMRC enquiry or negotiations. A clear understanding of the factual position will help the buyer form a view both on potential historic liabilities within the target and also what will need to be done to manage the trust arrangements going forward, in order to avoid unexpected future tax charges.

A key point to recognise from the outset, which sets this situation apart from other issues that may routinely be uncovered in due diligence, is that the trustees of a trust must act in the best interest of the beneficiaries (i.e. employees of the target), and not the target itself or the buyer. Trustees cannot be required to take whatever steps the buyer dictates, if to do so would be a breach of trust. This raises the issue of the extent to which the buyer will be able to control the occurrence of taxable events in relation to the trust following the transaction, which of course in the disguised remuneration era could be triggered by as little as an 'earmarking'.

It follows that one of the areas the buyer will need to look at in detail is the terms of (and parties to) the trust documentation. Points to investigate include:

- Who is/are the trustee(s)? If the trustee is an independent third party (as opposed to, say, a group company of the target that will be acquired as part of the deal), the buyer must consider whether it would be prepared to continue with the current trustee in place (assuming the trust will continue to exist after the transaction). If not, what powers would the buyer have post-transaction to replace the current trustee? Equally, if the buyer wishes to be sure that the current trustee will not be replaced, the terms of the trust instrument need to be checked carefully to ensure that the power of appointment

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and removal of trustees will rest with a buyer controlled entity (i.e. whilst one might expect this power to be vested in the (target) settlor company, it is possible that the trust could have an individual 'protector' able to exercise this power, who would typically be one of the shareholders of the target, in a case where the target is not being sold out of a corporate group).

- Is the trust subject to English law? Offshore trusts may well be subject to a law of an overseas jurisdiction. If so, specialist legal advice may be needed in the relevant jurisdiction, particularly if there is a need to alter the terms of the trust or to rely on indemnities contained in it.

- What tax indemnities or tax deduction/ recovery rights and obligations exist in the trust documents? A potential concern here is that the provisions in trust documents permitting trustees to account (either to the employing company or directly to the tax authorities) for tax on taxable events will typically pre-date the disguised remuneration rules. Whilst straightforward taxable distributions to beneficiaries should not pose a problem, it may be much less clear whether the terms of the trust would allow the trustees to account for income tax or national insurance liabilities on, for example, an 'earmarking' of assets for the benefit of an individual.

- Having built up as complete an understanding of the arrangements as possible, the buyer will need to consider how to protect itself in the sale and purchase documentation from tax exposures both for historic steps and any future actions of the trustee.

It goes without saying that a robust specific tax indemnity in the sale and purchase documentation will be a minimum requirement. The buyer will also need to consider which of the standard exclusions from liability, which sellers seek to insert into sale and purchase documentation, should apply to any specific indemnities for remuneration planning. For example, a buyer would justifiably be nervous about accepting the common exclusion for tax liabilities created or increased by 'postcompletion voluntary acts' of the target or the buyer. If this exclusion is accepted in principle, there would need to be careful drafting to address the interaction between that exclusion and whatever provisions are agreed as regards which party has conduct of the dispute with HMRC post-transaction, and also the potential significance of post-transaction disguised remuneration 'relevant steps'.

Resolving the dispute with HMRC

Even in M&A transactions where there are no ongoing or threatened HMRC enquiries, the provisions dealing with the conduct of claims under the tax covenant/tax deed often give rise to the most hotly debated tax drafting negotiation points – where the target is subject to a challenge over historic remuneration planning, even more so. The seller(s), given their historic and ongoing involvement in the arrangements and the fact that they are 'on the hook' under the indemnities in the sale and purchase documentation, will understandably wish to keep as much control as possible over the conduct of any settlement or litigation procedure following the sale of the target. The buyer will be keen to avoid drawn out, costly and potentially fruitless litigation over which it has limited rights of control. Ultimately, much will depend on the relative bargaining strengths of the buyer and

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sellers in the transaction generally, but there are other factors to consider; for example the sellers may have signed up to a 'package' of sorts when implementing the planning, under which the tax advisers promoting the planning were contractually granted rights of conduct over any HMRC enquiry at least as far as, say, the First-tier Tribunal. Needless to say, this would be unattractive to a buyer.

Assuming any issues over the ongoing involvement of the advisers who promoted the planning can be overcome, a possible compromise on conduct may be for the parties to agree to the joint appointment of an independent third party to act on behalf of the target. The role of the third party, which could be a firm of accountants or law firm, would be to seek a settlement with HMRC on behalf of the target. If this step is taken, clearly the detailed terms of appointment of the third party will be keenly negotiated, but broadly one would expect the overall thrust of the instructions to be to come to a settlement as quickly and efficiently as is reasonably practicable, whilst seeking to minimise the exposure of the target as far as can reasonably be achieved, taking into account any outcomes of other similar cases.

Retentions and insurance

Given that it may take some time after completion of the acquisition for final resolution or settlement of any liability to be reached with HMRC, and the amount of tax at stake will usually be relatively clear (although there may be debate about the level of any penalty that HMRC may ultimately seek to assess), the buyer will most likely seek to make a retention from the consideration payable for the target. The terms of the retention will need to be drafted carefully, considering in particular:

- at what point will any dispute be treated as finally resolved, triggering the release (if any) of the balance of the retention to the sellers?

- the buyer will most likely wish to insist that any settlement with HMRC, in order to be considered final for the purposes of the retention, must cover (in addition to the historic liabilities) the consequences of future actions, particularly the disguised remuneration position. Given that a settlement under the EBT settlement opportunity effectively negates any disguised remuneration charges that may have otherwise arisen in the future in respect of the relevant assets, this form of settlement would be popular with a buyer. Clearly, indemnity cover and large retentions begin to look less appealing on all sides if there is a potentially unlimited period after completion of the transaction during which further tax charges could be triggered.

If a retention is to be sought, commercially it needs to be raised as early as possible. In small and medium-sized deals, the amount of any retention could be very significant in terms of the proportion of the share consideration being retained, given that a buyer will seek to factor in anticipated charges to PAYE income tax and employee and employer NIC (on a grossed up basis in a worst case scenario), as well as interest, penalties and potentially costs anticipated to be incurred by the buyer or target after the transaction.

A final practical step for a buyer to consider is insurance, where the sellers may be unable or unwilling to provide a sufficiently comfortable level of protection, or there may be a concern over the sellers' ability to meet a significant indemnity claim some time after completion of the transaction, if sufficient funds are not retained from the share purchase consideration.

Conclusion

Having gone to the time, effort and cost of identifying what it believes to be a prime target for acquisition, the last thing a client (or our colleagues in the corporate department) wants to hear is that there is a big tax problem that may throw a spanner in the works. Provided that issues such as those raised here are identified and put on the table as early as possible in the transaction process, it should be possible to get a buyer into a position where it is comfortable proceeding with the transaction, despite the potential liabilities existing in the target and the practical steps required to resolve the position post-completion. If the buyer decides that it is not prepared to buy the target, further work needs to be undertaken to see if the parties can come to another arrangement (for example, a business sale or hiving trade and assets into a clean newco and acquiring newco) that works commercially and from a tax perspective for all parties.

Reclaiming VAT in relation to pension fund management following the ECJ decision in PPG (C-26/12)

By Darren Mellor-Clarke

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Employers running pensions schemes for employees may now be able to recover VAT incurred in relation to investment management services for the fund. Until now, HMRC's policy has been to allow such VAT only to be recovered by the fund itself.

Background

Litigation is on-going concerning the liability of management services provided to pension funds. Thus far, exemption for a defined benefit scheme appears to have been rejected by the ECJ, but the question of defined contribution vehicles remains open, awaiting judgement in the *ATP* reference to the ECJ (C-464/12).

In the interim, the *PPG* reference to the ECJ concerned the question of whether, in certain circumstances, an employer may recover VAT charged to it in relation to the management of the pension fund. In the UK, HMRC's historic position has been that employers may recover as residual input tax VAT incurred in relation the administration of the pension scheme itself. Conversely, VAT charged in relation to the management of the fund's assets has been recoverable as input tax only by the fund itself. As many pension funds invest heavily in equities and other financial instruments, the ability to recover VAT within the fund has been heavily reduced leading to significant irrecoverable VAT cost within the funds.

PPG is a Dutch manufacturer of fibre glass. It established and operated what, in the UK, would be referred to as a Defined Benefit ("DB") scheme for its employees. The employing entity contracted with third party suppliers to provide investment management and administration services for the fund. The employing entity paid the third party suppliers and did not charge those costs onto the fund. PPG claimed input tax recovery in the employing entity and the Dutch tax authority assessed it for over-recovered input tax.

PPG appealed the decision and the Dutch court referred two questions to the ECJ:

- Could PPG as the employing entity recover VAT on the costs in question?
- Could a pension fund such as the one in question, qualify as a Special Investment Fund for purposes of the VAT Directive and thus benefit from exemption in relation to its management?

The decision

The Court noted that due to its answer in relation to the first question and also the Court's previous decision in the *Wheels* reference (C-424/11) there was no requirement to answer the second question of the reference.

On the substantive matter of the first question, the Court ruled as follows:

The deduction system for VAT is intended to relieve the operator entirely of the burden of VAT paid or payable in relation to all his economic activities, thereby ensuring complete neutrality of a taxation of all those activities.

For a taxable person to be granted the right to deduct and to determine the extent of that right, it is necessary, in

Reclaiming VAT in relation to pension fund management *(continued)*

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principle, to establish a direct and immediate link between the particular input transaction and an output transaction(s) giving rise to a right to deduct. The taxable person also has a right to deduct if there is no such direct and immediate link, but the costs in question form part of the taxable person's general costs and so are components of the price of the goods or services he supplies – i.e. what would usually be referred to as "residual" costs in the UK.

The Court noted that the sole reason for PPG setting up the fund was to comply with obligations imposed upon it as an employer. Further, the legal and fiscal separation of the pension fund is a requirement of law, not choice.

Against such a backdrop of requirements, the Court held that as far the services in question formed part of PPG's general costs then they would be components of the price of PPG's products. In such circumstances a direct and immediate link is established as the sole reason for PPG purchasing the services was to continue its general taxable activities. In short, input tax recovery is, in principle, available for PPG.

It should be noted that the Court also held that to decide otherwise and deny the right to input tax recovery in such circumstances would undermine the neutrality of the VAT system, as set out earlier in its judgment. It also noted that the taxable person should be free to choose organisational structures and forms of transactions which are appropriate and facilitate their limiting their own tax burdens.

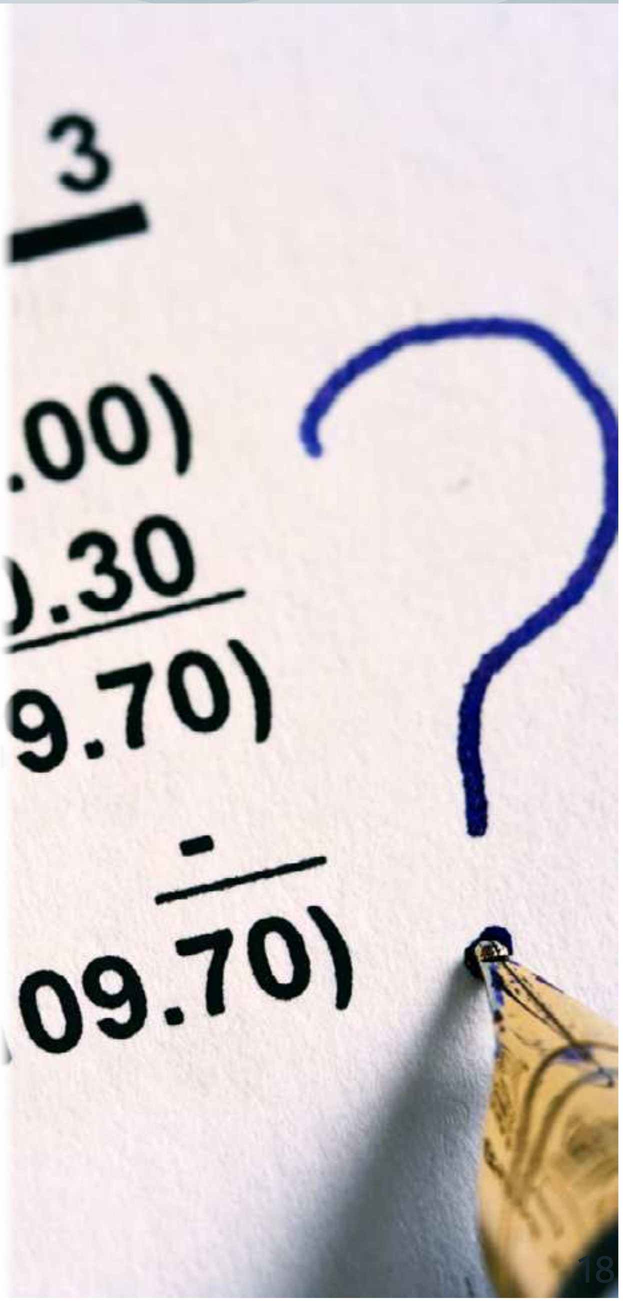
Implications for businesses

This decision considerably widens the employer's right to recover input tax relating to investment management for the fund.

Opportunity exists both to optimise the recovery position going forward, but also make retrospective claims for VAT already incurred. Any such claims are likely to have most value in businesses enjoying full VAT recovery or a high residual rate under their partial exemption method.

Potential claimants should give thought to the various conditions laid down by the judgment. In particular, whether the investment management costs are borne by the employer as opposed to the fund. Any recharges such as hard transfers of cash between the employer and the scheme, or other "soft" recharges, perhaps through netting arrangements, would need to be assessed fully before making a claim. Assuming that the fees incurred remain within the employer, then consideration should be given to whether they are counted as "general costs" within the business.

The issue should be considered fully not only by the employing entities, but also fund trustees. ●



Trends and Developments in UK tax for 2013

By Eloise Walker

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In the international arena, at least as far as the UK and the rest of the G20 are concerned, the story for 2013/2014 is going to be all about Base Erosion and Profit Shifting (BEPS). But what is BEPS? Ask the media, and they will say it is the media-led movement to encourage multi-national companies to pay more corporation tax. Ask most governments however, and you get a slightly different answer – it is all about preventing multinational companies from avoiding taxation in their home jurisdiction, by artificially diverting taxable activities abroad to low tax countries or mis-using the provisions of double tax treaties and domestic law to achieve double non-taxation so that their profits are not taxed anywhere at all.

BEPS will be such a hot topic for the UK mostly because ongoing media attention on the issue is making it a political agenda item and a reputational matter for the corporates involved, which affects their brands, but partly also because certain governmental bodies (notably the Public Accounts Committee, which is supposed to be no more than an internal parliamentary oversight body in charge of overseeing whether the tax payer is getting value for money out of public services) are enjoying considerable media exposure from their consideration of the UK Revenue's performance on tax collection, and partly because it will probably suit the UK Exchequer to use it as an excuse to attack any double taxation relief rules they do not like, in its name.

The Organisation for Economic Co-operation and Development (OECD) – which, as part of its wider socio-economic functions, makes recommendations in relation to international law for avoiding double taxation through measures such as the OECD model tax treaty and guidance on the proper attribution of profits to local branches of foreign corporations – published on 19th July 2013 an action plan for the G20 in relation to BEPS setting out 15 specific actions to prevent international tax avoidance, with a timeline for implementation. See the article by Heather Self, later in this edition of PM-Tax, for more information on the OECD's Action Plan on BEPS.

The UK's approach to this is likely to go in several directions:

First, it may get mired in attempts to put together a multi-lateral inter-governmental treaty aimed at tax avoidance (although, if other attempts at international co-operation are any indication, the chances of such a process proving swift or comprehensive are small, and the OECD themselves see this as a medium term goal).

Second, it is also likely to be looking to amend the UK's double tax treaties, particularly the definition of "permanent establishment" which, alongside the concept of "residence", currently governs who is taxable where, although renegotiating treaties tends usually to be a long drawn out process taking some years.

Third and more immediately, it will almost

Trends and Developments in UK tax for 2013 *(continued)*

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certainly in the near future put in place further anti-avoidance legislation aimed at so-called "hybrid mis-matches" (essentially, entities treated differently in two countries so that they are taxed in neither), disallowance of "double dips" (where two countries allow the same item to be deducted in their tax computations, giving a double deduction for the same expense), and "excessive" interest deductions (usually generated in high tax countries where excessive (with reference to external third party debt) intra-group borrowing generates deductions to offset against taxable profits). And all this despite the fact that the UK already has some of the most complex rules in the G20 aimed at tax avoidance and arguably already has all the tools it needs to tackle BEPs in the form of, for example, its anti-arbitrage, transfer pricing, controlled foreign company and worldwide debt cap rules. The UK's relatively generous rules for interest relief, and the controlled foreign company rules for intra-group financing (the finance company partial exemption) look likely to come under particular pressure.

Outside the arena of political rhetoric, it will be interesting to see how far in practice the UK Government aligns with current popular (i.e. media) opinion in relation to the taxation of corporations, because the Government appears to be somewhat of two minds here. On the one hand, tackling tax avoidance is potentially an election-winning agenda item, so we have for example recently seen the introduction of a GAAR (general anti-abuse rule) aimed at stopping those schemes that are perfectly legal but mis-use the tax code in some "moral" respect. On the other hand, the UK (like every Western nation) wants big business to be attracted to the country, so we will be seeing the UK corporation tax rate drop to 20% from April 2015; a change which will, oddly enough, make the UK itself a tax haven in the eyes of certain other jurisdictions.

This dichotomy is not limited to the international arena either. One of the interesting trends we have been seeing in the last 18 months, which looks set to continue over the next year, is the "favouritism" shown certain sectors such as media, pharmaceuticals and oil and gas, as against others such as infrastructure and banking, in how allowances are being given and legislation is developing. Take, for example, the "Patent Box" regime, newly introduced for the pharmaceuticals sector, which reduces the corporation tax rate to 10% on certain patents. Or the likelihood of legislation giving a reduced tax rate on the profits of fracking, to encourage shale gas production (although that reduced rate is still likely to be more than 30% overall, so not as generous as it might be). Compare this with the position for banks, where it is curious to note that an economy that has discouraged much of its manufacturing operations in favour of the financial sector, on which it now depends, has introduced tax levies on that sector under the guise of improving risk-related behaviours – it is likely that there will be further amendments made to the bank levy in Finance Bill 2014, given the recent consultation document published in July 2013 on its operation, but one thing that is now certain is that it will be here with us to stay for the foreseeable future. Also expected are developments in the Code of Practice on Taxation for Banks – originally introduced as a voluntary code to discourage tax avoidance practices – which, if the UK Revenue's proposals in a recent consultation were to go forward, may result in banks being required to confirm their adherence unconditionally or be "named and shamed" in an annual Revenue report on compliance. Whether or not these particular proposals advance, this indicates a growing tendency in the UK to penalize in the court of public opinion those who engage in tax planning, and expresses a move away from the Revenue's traditional stance in favour of taxpayer confidentiality.

Similarly, consider UK construction companies, where regardless of the headline corporation tax rate, infrastructure projects are still suffering effective tax rates above 30% due to the absence of any infrastructure relief following the abolition a few years ago of industrial buildings allowances. It is curious, given recent Governmental pronouncements on the commitment to invest billions in UK infrastructure, that there be no tax breaks to ensure third party private sector investment (especially for cash-rich pension funds who can currently get better returns elsewhere), but – absent the unexpected - no substantial developments are planned in this area any time soon. Developments against the sector are not confined to the absence of tax reliefs either. The imposition of new rules this year relating to procurement – specifically the awarding of government contracts to construction companies – are being utilised as an indirect way of encouraging tax compliance by

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making failure to certify tax health a criterion for rejection in the procurement process: an interesting example of the use of Government buying power to effect a social change in behaviour.

The UK Revenue's mind-set in recent years has had a tendency to start from the position that every taxpayer is out to avoid tax and must be prevented from doing so at all costs. Such a focus on anti-avoidance, though entirely understandable (especially in the current media and political climate), is generating a developing trend to make new legislation ever more complex. A targeted anti-avoidance rule (TAAR) has been added to almost every piece of tax legislation proposed for the coming year, almost as if the thought is that simplification must equal a tax avoidance opportunity, instead of starting with user-friendly legislation that is practical in scope and adding a gloss of anti-avoidance principles as needed.

One particularly interesting trend to note is the UK Revenue's increasing tendency to propagate anti-avoidance measures under the headings "simplification" and "modernisation". In recent years, the UK has seen its legislation proliferate into an ever greater sprawling mass of statutes. The process started by the Tax Law Rewrite project – of taking piecemeal chunks of provisions in old legislation, expanding them out and scattering them across multiple Acts – is alive and well in, notably, the UK Revenue's planned consultation over the next couple of years on the treatment of loan relationships and derivative contracts. But whilst the Tax Law Rewrite project had the laudable aim of preserving the substance of the law whilst making the statutory provisions easier to understand (for an easier read and a more sensible layout), consultations such as the one on loan relationships and derivative contracts appear to be aimed at changing the law to suit the UK Revenue and creating not simplicity but uncertainty, by introducing guiding principles almost along the lines of "follow your accounts, unless we disagree in which case we will override them with the concept of a "fair" amount of tax". Hopefully, as proved the case with the overhaul of the controlled foreign company rules, this consultation on the treatment of corporate debt and hedging instruments will ultimately produce a sensible compromise – but given the controlled foreign company regime overhaul took over five years, the UK Revenue may be optimistic in thinking just two will be sufficient this time. In the meanwhile, the uncertainty such consultations engender cannot be a good thing for the UK economy and is unlikely to encourage foreign businesses to invest here in the short-term.

The OECD's Action Plan on Base Erosion and Profit Shifting

By Heather Self

This article was first published by Practical Law Tax on 6 August 2013

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Heather Self of Pinsent Masons LLP briefly considers the OECD's *Action Plan on Base Erosion and Profit Shifting* (BEPS) of 19 July 2013 and the steps that multinationals should consider taking in the light of it.

On 19 July 2013, the *OECD* published its *Action Plan on Base Erosion and Profit Shifting* (Action Plan). The Action Plan is an ambitious attempt to co-ordinate multilateral action on international tax rules, and may be one of the most significant developments since the original publication of the OECD Model Tax Convention in 1963.

The global financial crisis has led to an intense focus by governments in the G20 on ensuring that they protect their tax base, with particular attention being paid to the activities of multinational companies (MNCs). The Action Plan lists fifteen areas in which action will be taken within two years wherever possible (Actions). The main focus is on "double non-taxation" (in other words, income which escapes tax completely), together with a review of the implications of the digital economy and an emphasis on disclosure. It is helpful that the report also re-emphasises that it is important to prevent double taxation and recognises that effective dispute resolution processes are needed.

The digital economy

Much of the public comment in recent months has centred around MNCs such as Google, Amazon and Apple. The OECD definition of "permanent establishment" (PE) has come under severe strain, since it is now relatively easy to make significant sales into a country without having a physical presence there. Action 1 will, therefore, examine the various business models in the digital sector and seek to identify the main difficulties, including not only the definition of a PE but the attribution of value and the application of source rules. Action 7 will also consider changing the definition of a PE to prevent artificial avoidance of PE status, for example, through the use of commissionaire arrangements.

Any change to the definition of a PE could have impacts beyond the digital sector: for example, the fact that a storage facility is not a PE is important for suppliers of commodities such as physical oil and gas. The idea that it would be simpler to tax "by reference to sales" ignores the difficulty of deciding where a sale is made if, say, a UK resident individual downloads a technical article on a tablet while travelling.

Transfer pricing

A number of the Actions relate to transfer pricing. There is a clear focus on ensuring that "transfer pricing outcomes are in line with value creation" (*Actions 8-10*), with a recognition that the current rules make it relatively easy to allocate valuable intangibles or financing activities to low tax jurisdictions, even if there is little economic substance there. The OECD acknowledged in its February 2013 report *Addressing Base Erosion and Profit Shifting* that the current rules focus too heavily on legal form rather than economic substance.

However, the OECD does not recommend wholesale reform, for example, by moving to a formulary apportionment system. This

The OECD's Action Plan on Base Erosion and Profit Shifting *(continued)*

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is a pragmatic response to the practical difficulties of getting anywhere near consensus on how such a system would work, as evidenced by the slow progress on the EU's Common Consolidated Corporate Tax Base (CCCTB) proposals.

Anti-avoidance

Actions 2 and 3 focus on the need for greater international co-ordination of anti-avoidance rules in areas such as the use of hybrid mismatch arrangements and the design of controlled foreign company (CFC) rules. The UK already has well-developed anti-arbitrage rules and has recently undertaken a detailed review of its CFC rules, so this may be an area where the need for UK change is limited.

Action 6 confirms that treaties are not intended to be used to create double non-taxation. The OECD will update its model treaty provisions to prevent treaty benefits being granted in "inappropriate circumstances".

Interest deductibility

A key focus for the UK will be interest deductibility. Action 4 says that the OECD will develop recommendations regarding best practice "to prevent base erosion through excessive deductions". The UK's relatively generous regime, supported by anti-avoidance rules such as the debt cap, is likely to come under pressure. However, that regime is a key element of the overall foreign profits package and helps to make the UK an attractive location for mobile capital investment.

Transparency

There is a recognition that transparency is important in ensuring that tax systems are working as intended. Action 5 focuses on harmful tax practices and will prioritise measures such as spontaneous exchange of information. Action 12 recommends that aggressive tax planning arrangements should be disclosed, possibly along the lines of the UK's disclosure of tax avoidance scheme rules.

Action 13 says that the OECD will develop rules regarding transfer pricing documentation, which may include requirements for more disclosure of allocation of income and economic activity between countries. However, the proposal is for disclosure to be made to governments and not for public country-by-country reporting.

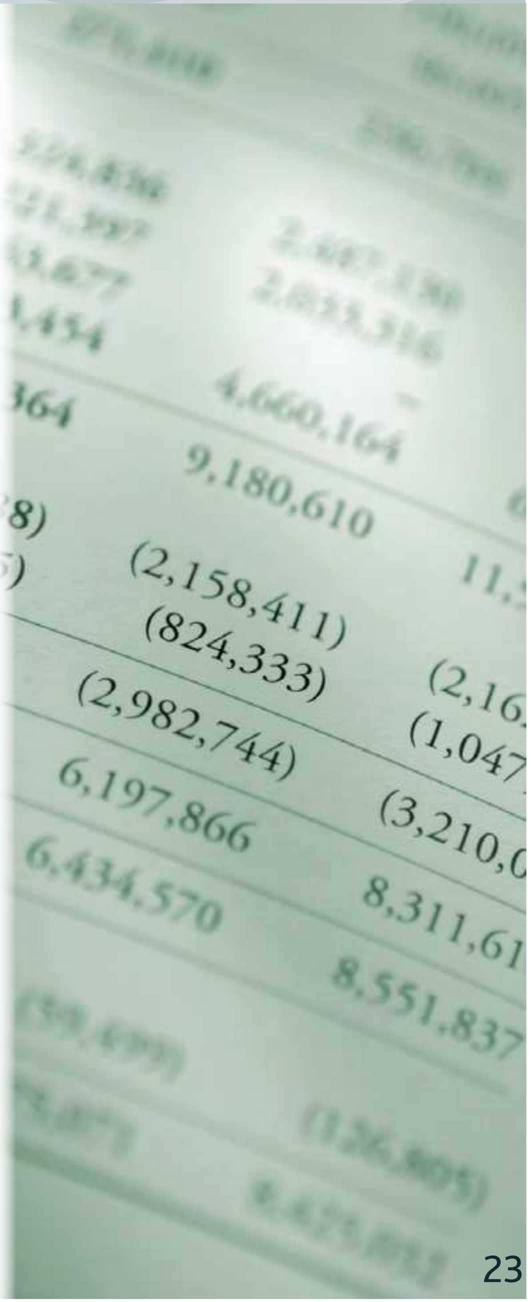
Conclusion

It will be some time before concrete proposals emerge so there are no urgent steps for multinationals to take. However, those with complex structures (and low effective global tax rates) should start to assess how robust those structures are, and whether the tax savings still outweigh the potential reputational costs.

Companies should also consider what additional information would need to be gathered to comply with potential transparency requirements, and build data-gathering capacity into reporting systems where this can be done cost-effectively.

If a group is planning an acquisition or major investment, the risk of additional taxes should be considered within the project appraisal. While tax should never drive a commercial decision, the uncertainty over potential changes may make marginal projects less viable.

Overall, this is both an ambitious and pragmatic package. Delivery will not be easy but, as the OECD recognises in the Action Plan, the risks of failure could include "global tax chaos marked by the massive re-emergence of double taxation." ●



Updated Tax and Procurement Practical Guide for Bidders and Buyers

The government's procurement policy changed with effect from 1 April 2013. From that date all government departments must require potential suppliers in respect of contracts over £5m to certify certain tax compliance aspects. This must be done as part of the Pre Qualification Questionnaire or Invitation to Tender process.

The supplier must certify whether or not it has had any "occasions of non-compliance". Such occasions, broadly, occur when a supplier has accepted, or a Court has determined, that additional tax is payable where certain anti-avoidance rules have been engaged. The certification covers all occasions of non-compliance from 1 April 2013 in respect of activity reported on tax returns submitted on or after 1 October 2012.

Where a potential supplier has an occasion of non compliance there is the opportunity to submit an explanatory memorandum of mitigation.

If a bidder certifies an event of non-compliance it may be excluded from the bidding process. Where contracts have been awarded and an occasion of non compliance occurs during the contract lifetime, this may be grounds for termination of the contract. The consequences of getting this certification wrong are therefore potentially very serious.

Pinsent Masons has updated its practical guide to tax and procurement for bidders and buyers to reflect revised guidance issued by the Cabinet Office.

Click here for our guide

Substance

Ardagh Group SA v Pillar Property Group Limited [2013] EWCA Civ 900

A clause in a share purchase agreement should be interpreted literally so that additional consideration was payable when capital losses in the target company were used, even though they were used as part of a package deal agreement with HMRC of a group's liabilities, which did not result in the company getting the full economic benefit of the use of the losses.

Pillar bought the shares in a company called Yeoman from Ardagh. The share sale agreement provided that Pillar would pay £2.2m on completion and further contingent consideration if capital losses could be used after the sale. It stated "the Purchaser shall pay to the Vendor an amount equal to nine per cent of the losses used by any member of the Purchaser's Group or the Company by virtue of the effective off set against a taxable profit or gain, by such company of all or any part of... allowable capital losses for tax purposes of the Company".

Pillar had been advised that that the capital losses in Yeoman may be available after the sale because of the wording of the pre-entry loss anti avoidance rules. After the sale Yeoman claimed the offset of some £82 million of losses but HMRC denied the claims. Yeoman was then sold to British Land. A number of years later HMRC issued a closure notice denying Yeoman the benefit of any of the set-offs claimed. Yeoman appealed and its appeal was compromised by a "package deal" agreement with HMRC settling a number of disputed tax issues within the British Land group. The effect of the agreement was that HMRC agreed the £82 million losses in Yeoman could be used, but various other claims arising in the British Land group were denied and other tax liabilities arose.

Ardagh claimed that, as a result of the settlement with HMRC, the obligation to pay additional consideration had been triggered and Pillar claimed that it had not.

Ardagh applied for summary judgment on the ground that Pillar had no real prospect of succeeding in its defence. The High Court judge refused the claim for summary judgment and Ardagh appealed to the Court of Appeal.

Ardagh argued that clause 6.1 of the Sale Agreement, which dealt with the contingent consideration, should be interpreted literally so that Pillar should pay an amount equal to 9% of Yeoman's allowable losses which HMRC agreed could be set off against the taxable profit or gain of Yeoman or any member of Pillar's group. Pillar argued that the proper interpretation of clause 6.1 is that Ardagh is entitled to an amount equal to 9% of any commercial net benefit which Yeoman or any member of the Pillar Group has obtained from setting off Yeoman's allowable losses against the taxable profit or gain of Yeoman or of any group company.

The Court of Appeal found for Ardagh and allowed the appeal. Sir Terence Etherton agreed with Ardagh that the clause 6.1 should be interpreted literally. Set off is "effective" when the set off of those losses is agreed by the Revenue or upheld by the court. The contract did not include the sort of more complicated machinery that would have been required if the parties had intended that there should be some evaluation of the commercial benefit of the use of the losses.

He said that this literal interpretation did not produce a commercially unmeritorious benefit for Ardagh as British Land chose to structure the deal with HMRC so as to minimise the interest it would have to pay on overdue tax. He said that there was nothing in the evidence to suggest that it would have been impossible or difficult to structure the package deal by taking advantage of the losses other than Yeoman's losses. In that event, no contingent consideration would have been payable under clause 6.1.

Our Comment

Even if the events in this case had been foreseen, anyone drafting the contract would have assumed that Yeoman would not have chosen to use the capital losses in circumstances when it was not going to get a benefit from the losses which exceeded the amount it would have to pay to Ardagh in additional consideration. The case illustrates the dangers of those sorting out the future tax affairs of a group not being aware of the terms of commercial agreements entered into many years before and shows the need for close liaison between tax and legal in-house teams.

Read the decision

Substance

Julian Massey and Beryl Massey t/a Hilden Park Partnership Appellant and Hilden Park LLP v HMRC [2013] UKFTT 391 (TC)

The burden of proof in a Halifax abuse of rights case, rests on the taxpayer as the taxpayer controls the evidence relating to the disputed transactions. A transaction was "abusive" pursuant to the Halifax doctrine where an exempt trader leased assets on non-arm's length terms.

Arrangements were entered into to convert a golf club from a proprietary club (where VAT was chargeable on its supplies) to one owned by a "not-for-profit" organisation whose supplies would be exempt under Group 10 of Schedule 9 to the Value Added Tax Act 1994. The land was held by HPP (a partnership which subsequently became an LLP) and the golf course, driving range and an area of the complex was jointly let to two non profit making companies (Members and Visitors). HPP's business of allowing persons to use the golf course, driving range and health club was transferred to the two companies: the business of making supplies to members was transferred to Members and the business of making supplies to non-members was transferred to Visitors.

HMRC alleged that in adopting this new structure HPP was trying to avoid paying VAT on supplies of sporting services which would otherwise have attracted VAT and that this amounted to an abusive tax avoidance arrangement liable to redefinition under the Halifax doctrine – so that HMRC could assess HPP for the VAT. HPP appealed to the FTT.

As a preliminary issue HPP argued that in a Halifax case the burden of proof rests on HMRC and not the taxpayer. The burden of proof is on the taxpayer in the tax tribunal unless it involves an allegation of what would be a criminal matter were the tribunal a criminal court and in certain other circumstances, such as MTIC cases. The FTT judge decided that in a Halifax case the burden of proof rests on the taxpayer, as the taxpayer controls the evidence relating to the disputed transactions.

In Halifax the CJEU said "The application of Community legislation cannot be extended to cover abusive practices by economic operators, that is to say transactions carried out not in the context of normal commercial operations, but solely for the purpose of wrongfully obtaining advantages provided for by Community law".

The FTT judge decided that although it is legitimate to set up a structure so that an exempt trader leases rather than buys assets, an abusive tax advantage is generated by leasing on terms which do not correspond to arm's length terms. There can be abuse even if the structure used by the taxpayer is not by itself abusive.

The judge compared the arrangements with what would have happened if the site had been let to third party operators rather than Members and Visitors. She found that the payment of rent was a covert payment of profit by Members and Visitors to HPP. Reasons included the fact that the lease and other agreements were not negotiated in any meaningful sense by the directors of Members and Visitors and the rent was considerably higher than the two companies could afford to pay and considerably higher than was agreed a few years later when the golf course was let to an independent third party.

The fact that there was a covert profit meant that Members and Visitors were not truly non-profit making and therefore the VAT sports exemption did not strictly apply. If this was the case there could be no tax advantage and therefore it was questionable whether the Halifax doctrine applied at all. However, the judge decided that Halifax did still apply. "Where the taxpayer took the tax advantage because he considered (incorrectly) that the scheme succeeded in law, then it is still abusive" she said.

Read the decision

University of Huddersfield v HMRC [2013] UKFTT 429 (TC)

A VAT lease and lease-back scheme which initially resulted in a deferral of tax, rather than avoiding tax altogether, was not an abuse of rights pursuant to the *Halifax* principle.

The University entered into a lease and lease-back scheme relating to land it wanted to redevelop to use for its purposes as a university. If it had simply developed the land it would not have been able to recover the VAT input tax on its construction costs to the extent that it was making exempt supplies and so it entered into a scheme.

Substance

The land was leased to a discretionary trust which leased the land back to the university. Both the University and the trust opted to tax in relation to the land. The scheme was a "cash flow" VAT scheme, enabling it to deduct input tax incurred on the redevelopment of a property, but requiring the University to pay VAT on the rent when the land was leased back to it

The only reason for using the trust was to obtain the VAT advantage – if the property had been leased to a subsidiary company, as the law applied at that time, the university would not have been able to opt to tax, due to an anti avoidance provision. Similarly the only reason for the lease and leaseback was to achieve the VAT deferral. It was intended that the arrangements would eventually be collapsed to obtain an absolute VAT saving.

HMRC challenged the input tax recovery and the case went to the VAT Tribunal. The question of whether there was an abuse of rights was referred to the CJEU by the VAT Tribunal and was considered at the same time as the *Halifax* case, albeit with a separate judgment in 2006.

The ECJ decided that the lease and underlease were supplies which constituted an economic activity. However, the ECJ did not decide whether the transactions were abusive. The FTT therefore had to decide this question in the light of the CJEU decision and *Halifax* and subsequent cases.

HMRC argued that using the independent trust in the leasing arrangements, which meant that the disapplication of the option to tax rules in Schedule 10 to the VAT Act 1994 could not be applied, allowing the University to recover input tax in full, was an artificial step and therefore contrary to purpose of the VAT Directive.

The University contended that the exercise of the option to tax, generating the right to recover input tax on costs incurred in relation to its supply of the land was not abusive. It relied on the ECJ's ruling in *Weald Leasing* (C-103/09) which clearly stated that leasing per se was not abusive provided it was made on commercial terms, even when utilised by an exempt/partially exempt taxpayer to recover VAT (either upfront or by drip-feeding as was the case in *Weald*) that ordinarily it could not recover in a straight sale scenario.

The Tribunal Judge agreed with the University and decided that the particular arrangements in question were not contrary to the purposes of the legislation and thus were not abusive. He considered that HMRC should not have assessed back in 2000, because at that time, no absolute tax benefit had attached to the Appellant – this only crystallised in 2004 on the collapse of the leasing arrangements. The Tribunal also commented that HMRC's method of assessment was flawed as it did not relate to any rent levels or terms of the lease or any tax saving – and should have been based on a sum that was "redefined" so to account for the VAT incurred, and not recovered on the lease-back from the trust by the time the leases were collapsed.

Our Comment

There was a very helpful comment by the Tribunal Judge regarding the scope of redefinition in abuse cases. Referring to the judgment in Weald, he confirmed that the correct way to redefine was to identify "the precise aspect of the arrangements in point that constitute the abuse, and then redefining the transactions in question so as to establish the situation that would have prevailed in the absence of the particular element(s) constituting the abuse. And, where the problem lies in a particular provision of an agreement, the redefinition requirements apply in relation to that provision". This cuts across HMRC's over-used argument in relation to abuse cases and leasing arrangements that redefinition should recharacterise transactions as an outright sale, and completely undo a lease arrangement.

This case has been on a long journey – to Luxembourg and back, but despite that ultimately it came down to how the facts stacked up against the guidance from the ECJ in *Halifax*, *Weald* and other cases. The Appellant benefited from the comments in Weald that leasing was a normal commercial activity, and taxpayers should be entitled to enter into lease and leases on arms lengths terms to enable VAT recovery – the key question is whether the terms of the arrangement make that leasing arrangement non-commercial (just as very low level of rentals as contended in *Weald*), and it is that fact that can turn an arrangement into an abusive practice contrary to the purposes of the VAT Directive.

However, there's another chapter to come in this story, HMRC have appealed this decision to the Upper Tribunal.

Read the decision

Substance

Russell Baker v HMRC [2013] UKFTT 394 (TC)

Payments to a shareholder in satisfaction of a purported purchase of own shares are not taxable as distributions if the requirements of the Companies Act in respect of a purchase of own shares have not been satisfied.

Following a falling out between two shareholders in a private company it was decided that Mr Baker's shares in the company would be purchased by the company for a total payment (in cash and in kind) of £120,000. Mr Baker made no mention of the purchase of his shares by the company in any tax return. HMRC opened an enquiry into Mr Baker's tax return for the relevant year and assessed him to tax on the £120,000 as a distribution. Mr Baker appealed and when legal advice was taken it transpired that the purchase of own shares was void as the company had not had sufficient distributable reserves. The company then went into liquidation.

HMRC argued that notwithstanding any breach of company law, the transaction had still actually taken place and the "economic reality" of what had happened was that the company had purchased its own shares from Mr Baker in exchange for the cash payments and other assets transferred to him. Alternatively, if it was not a purchase of own shares HMRC argued it was some form of other distribution or a loan to a participator which had been released. Mr Baker argued that the transaction was void as matter of company law and as the company was entitled to recover the £120,000 from him, he could not be taxed on it as a distribution.

The FTT judges discounted any suggestion that Mr Baker should be taxed on the basis of the "economic reality" of what took place. They said "Such a submission has a degree of unreality about it, bearing in mind the approach taken by HMRC in the sad appeals from defrauded investors in complicated life insurance bonds who have lost most or all of their investment but are still being taxed by HMRC on entirely fictitious gains arising under the life policy 'chargeable events' rules."

The FTT judges said that Mr Baker was under an obligation to return the various cash payments and assets and so the payments could not have amounted to a distribution for tax purposes. Even if the payments were regarded as a loan to Mr Baker, the facts did not support the argument that it had been released by the company in the tax year for which HMRC had made the assessment and so had given rise to a tax liability under the loan to participator provisions in that tax year.

The appeal was therefore allowed but the judges warned that "this may not be the end of the matter for the Appellant" as HMRC may raise an assessment for a subsequent year.

Our Comment

This case confirms the importance of taking appropriate legal advice and complying with company law if payments are to have the legal effect desired.

Read the decision

HMRC v DV3 RS Limited Partnership [2013] EWCA Civ 907

The Court of Appeal has decided that an SDLT scheme involving the interaction of the sub-sale rules and the partnership rules failed.

DV3 had a lease of the Dickins and Jones building on Regent Street in London. It agreed to buy the head lease of the property from Legal and General (L&G) for £65.1 million. It entered into a scheme to avoid the £2.6m of SDLT that would otherwise be payable.

DV3 set up a limited partnership in the British Virgin Islands (BVI). DV3 was one of the partners and entitled to 98% of its income. The other partners were two general partners, another company and a unit trust. DV3 agreed to sell on the head lease in the property to the partnership on the same day as the contact between itself and L&G was completed. This sub-sale was completed by a transfer from DV3 to the partnership, rather than a transfer directly from L&G to the partnership.

The effect of the sub-sale rules in force at the time was to prevent SDLT from being chargeable on the contract between L&G and DV3. Instead, the legislation created a deemed contract with the partnership as purchaser on which SDLT was chargeable. It did not state who the seller should be under this secondary contract.

The partnership argued that the effect of the SDLT partnership rules was that the chargeable consideration for the transfer of the property to the partnership would be treated as nil because DV3 and people connected to it were the partners in the partnership. However, HMRC said that the effect of the sub-sale rules was that DV3 was not the seller under the deemed secondary contract with the partnership and so SDLT was payable.

DV3 succeeded in the FTT and the UT. HMRC appealed to the Court of Appeal.

Lord Justice Lewison agreed with HMRC's analysis, finding that "it was illegitimate to ignore that reality of the contract between L&G and the Company and the Company and the Partnership; or the transfers that amounted to completion of each of those contracts".

"[DV3] occupied a real place in the transactions agreed in the real world, and that reality could not be ignored," he said.

"We know that in the real world the Partnership had a contract with the Company. We know that in the real world that contract was completed by the execution of a transfer. We know also that in the real world what the Partnership acquired by those two steps was (at least) the whole equitable interest in the head lease. That is a chargeable interest. We can therefore say with confidence that the Partnership acquired a chargeable interest as a result of those two steps, even if the equitable estate in the hands of the Company was not a chargeable interest," Lewison LJ said.

The Court's analysis meant that the scheme failed.

Our Comment

The decision hinges on the partnership SDLT rules relied on by the taxpayer requiring a 'transfer' of a chargeable interest which did not occur in the Court's view. It points up the difficulties in interpreting the sub-sale rules and particularly the partnership regime in commercial transactions. The anti-avoidance provision, section 75A, was introduced soon after this scheme took place and would mean that the scheme would not work now. In addition, the sub-sale rules were amended in this year's Finance Act with a view to preventing continuing SDLT avoidance involving sub-sales.

Read the decision

McMahon v HMRC [2013] UKFTT 403 (TC)

A payment made by an individual to his former employer was not deductible against the profits of his trade as it was made partly to settle claims arising out of the breach of his employment contract.

Mr McMahon worked as a recruitment consultant for Quantica. He left Quantica to set up his own business. Quantica took legal action against him for breaching his restrictive covenants and emailing the company's customer list to his home address.

Quantica claimed "springboard relief" which, if successful would have resulted in a permanent injunction preventing Mr McMahon from contacting any of the customer's on Quantica's Top Client list. The dispute was settled and Mr McMahon agreed to pay Quantica £100,000 in full and final settlement of all claims brought against him and of all claims arising out of his previous employment.

Mr McMahon claimed a deduction from his trading income in his tax return for the £100,000 paid to Quantica together with the legal fees he had incurred. HMRC opened an enquiry into Mr McMahon's tax return and denied the deduction. Mr McMahon appealed to the FTT.

The issue to be decided was whether the expenditure was incurred wholly and exclusively for the purposes of Mr McMahon's trade, as required by section 34 Income Tax (Trading and Other Income) Act 2005.

HMRC argued that the damages paid by Mr McMahon were at least partly referable to his breach of his employment contract and so there was a duality of purpose and it was not incurred wholly and exclusively for the purposes of the trade. Mr McMahon argued that the payment was made for the sole purpose of preserving his business and should be deductible.

The FTT decided that the payment of £100,000 and the legal costs incurred by Mr McMahon had two purposes. One to preserve the business which, on its own, would have been wholly and exclusively for the purposes of the trade. The other to defend and settle the proceedings including the claim for damages for breach of contract and breach of fiduciary duty which

Substance

arose out of Mr McMahon's contract of employment. The judges said that this second purpose could not be described as merely an effect of preserving the business. It was part of the reason the expenditure was incurred.

The expenditure was not incurred wholly and exclusively for the purposes of Mr McMahon's trade and was therefore not deductible.

Read the decision

Interfish Limited v HMRC [2013] UKUT 0336 (TCC)

Sponsorship payments made by a trading company to a rugby club were not deductible for corporation tax purposes because one of the intended purposes of the payments was to benefit the rugby club and so the payments were not wholly and exclusively for the purposes of the company's trade. If the company had only had the ultimate purpose of benefitting its trade in mind when incurring the expenditure, the payments would have been deductible even though others making such payments may have wanted to benefit the rugby club.

Interfish, a fish processing, wholesaling and retailing business based in Plymouth made payments totaling £1.2m to Plymouth Albion Rugby Club. It claimed a corporation tax deduction for the payments and HMRC refused to allow the deduction.

Mr Colam, a director of Interfish, who effectively controlled Interfish was heavily involved with the rugby club. Interfish lent money to the club and made substantial payments to cover a deficit in the club's player budget. Interfish advertised on a perimeter hoarding and on players' shirts and Interfish's logo was on each page of the club's website. Interfish also used the club for business hospitality. A particular benefit to Interfish which Mr Colam perceived as a result of making the payments, apart from visible promotion of the company, was that it made it easier to obtain bank funding for Interfish's expansion, as one of the directors of the rugby club was a corporate director with Nat West.

In order for the expenditure to be deductible it had to be "wholly and exclusively laid out or expended for the purposes of the trade".

Before the FTT, Interfish contended that the payments were deductible but the FTT held that the payments were made for the benefit of the rugby club in order to benefit Interfish and therefore had a duality of purpose and so were not deductible. Interfish appealed, contending that in reaching the conclusion it did, the FTT made an error of law.

Interfish argued the ultimate purpose of the payments was to benefit Interfish and so the benefit to Plymouth Albion was merely a consequential and incidental effect that should be ignored.

HMRC argued that Interfish had two purposes in making the payments, to benefit Plymouth Albion and to benefit Interfish and this meant that the payments were not wholly and exclusively for the purposes of Interfish's trade.

The Upper Tribunal judge found for HMRC, saying that the legislation does not distinguish between undertaking the attainment of an *immediate* objective in order to attain an *ultimate* objective. "The question is not whether different purposes can be characterised as immediate or ultimate, the question is only: what were the actual objectives of the taxpayer? A taxpayer may have had only the so called ultimate purpose in mind in which case the payment is deductible regardless of the fact that one can analyse the case and see that another purpose could have been in mind too. Equally a taxpayer may have both the ultimate and the immediate purposes in mind, in which case the payment is not deductible regardless of the fact that one may be said to predominate over the other." he said.

The judge said that the question is only whether the taxpayer's actual purpose was exclusively (i.e. solely) a business purpose. If not then the test is not satisfied. The UT judge said that the FTT judge had found as a fact that one of the taxpayer's purposes in making the payment was to benefit Plymouth Albion. Since this was a finding which was plainly open to the FTT to make on the evidence in the case, the FTT's decision could not be overturned and Interfish's appeal was dismissed.

Read the decision

Forthcoming Seminars

The Pinsent Masons Tax team will be hosting the seminars detailed below.

Employee Share Ownership in Unlisted Companies – A Changing Landscape

The current Government focus on increasing employee share ownership in unlisted companies has led to an almost unprecedented number of initiatives in this area.

With the imminent introduction of "Employee Shareholder" status, this bespoke seminar will provide an overview of those initiatives, commentary on what they will mean in practice and insight into both the tax and commercial issues to consider when designing equity incentive arrangements in unlisted companies - regardless of whether the company is an owner-managed business, private equity-backed or managed by serial entrepreneurs. Specific issues we will cover include the continued relevance of Enterprise Management Incentive ("EMI") share options, whether we will soon see the demise of the employee benefit trust and what the future might hold as the Government continues to respond to the Nuttall Report.

Date: Monday 16 September 2013
Time: 4pm Registration; 4.15pm-6pm Seminar; 6pm-8pm Drinks reception
Venue: Pinsent Masons LLP, 30 Crown Place, London EC2A 4ES

Register

Doing Business in China

The rise of China as an economic superpower is one of the great stories of our age. Since joining the WTO in 2001, China has experienced unprecedented levels of economic growth and has become one of the top global destinations for foreign direct investment. Over the past few years the Chinese state has opened its doors to multinationals, enabling international corporates to take advantage of the significant opportunity available in the country.

In order to discuss some of the issues around establishing a presence in, or doing business with China and to explore some of the relevant tax issues for corporates which choose to set up in the country, we are delighted to announce that Robbie Chen, a Chinese qualified lawyer from the Tax practice in our Shanghai office, will host a breakfast seminar in London on Tuesday 17th September 2013.

Robbie will be available to answer any questions you might have including issues such as:

- The concept of Permanent Establishment in China
- Tax advantages and implications of providing services in China
- VAT in China

We hope you will be able to join us for a rare and though provoking insight into doing business in China.

Date: Tuesday 17 September 2013,
Time: Breakfast served from 8.00am; Discussion starts 8.30am and Close 10.00am
Venue: Pinsent Masons LLP, 30 Crown Place, London, EC2A 4ES

Register

Forthcoming Seminars

The Pinsent Masons Tax team will be sponsoring or hosting the seminars detailed below.

CIOT/ATT Scotland Branch 2013 Annual Conference

We are very pleased to be sponsoring the annual conference of the Scotland branch of the Chartered Institute of Taxation (CIOT) and the Association of Tax Technicians (ATT), which takes place in Stirling on 8 and 9 November.

The conference will be providing updates across a range of tax subjects and includes a session on the new Scottish taxes. John Swinney MSP, the Cabinet member responsible for Finance will give the key note address at the dinner.

Ray McCann, a partner (non-lawyer) from Pinsent Masons, who is Chair of Professional Standards at the CIOT will be one of the speakers and members of our tax team based in our Scottish offices will be attending.

All CIOT members and students, together with other tax professionals are invited to attend. If you are interested in attending you can find details here.

Ladies' Literary Evening with Sarah Dunant at Dr Johnson's House

Pinsent Masons invites you to a 'Ladies' Literary Evening' at Dr Johnson's House on Thursday 19 September 2013 from 6pm.

Our guest speaker for the evening is Sarah Dunant, author of the international bestseller 'The Birth of Venus', which has received major worldwide acclaim and 'In the Company of the Courtesan'. Sarah is patron of the Orange Prize for Fiction and reviews for various newspapers and magazines including The Times and The Observer, and is a regular presenter of BBC Radio 3's 'Night Waves'.

The venue for the event will be at Dr Johnson's House. Dr Johnson's House is one of the few residential houses of its age still surviving in the City of London. Built at the dawn of the eighteenth century, it was a home and workplace for Samuel Johnson from 1748-1759. It was here that he compiled the first comprehensive English Dictionary. The house has been beautifully restored and contains a fine collection of period furniture, prints and portraits. Situated to the north of Fleet Street, the house is found among a maze of courtyards and passages that are a living reminder of London's eclectic history.

Date: Thursday 19 September 2013
Time: Drinks and Canapés, 6pm until 9pm
Venue: Dr Johnson's House, 17 Gough Square, London, EC4A 3DE

Register

Pinsent Masons launches French tax practice

Pinsent Masons is launching a French Tax practice after appointing Eugénie Berthet in Paris.

Eugénie joins us from Marccus Partners and has extensive experience in cross-border employee share schemes and management packages, business transfers, international mobility and international tax planning for individuals. She also regularly advises on tax aspects of real estate matters and multi-jurisdictional property work.

In the past Eugénie has taught tax at the university of Versaillles St Quentin and at the Institut d'Etudes Politiques de Paris.

Prior to joining Marcuss Partners - the tax firm of major French audit company Mazars - she headed up the share plans practice at Landwell, PwC's tied law firm, and for several years practised as a tax specialist at Slaughter & May.

Pinsent Masons has one of the largest multidisciplinary Tax teams of any international law firm and has been growing that capability around the globe as part of its focus on the financial services sector. Last year the firm appointed 4 tax specialists as part of the expansion of its Shanghai office.

Jason Collins, Head of Tax at Pinsent Masons, says:

"Eugénie is a stand-out tax practitioner and her specialisms fit well with our focus on financial services, and the needs of our Private Wealth clients. We see significant opportunities around offering cross-border tax advice generally and the growth in share plans specifically."

Christoph Maurer, Head of the Pinsent Masons' Paris office, says:

"We are delighted to add Eugénie to our growing team in Paris. We have a growing team with a unique range of specialisms, and an increasing focus on those sectors where the firm sees most potential for growth. We are on the verge of taking more office space and the business goes from strength-to-strength in Paris."

Tell us what you think

We welcome comments on the newsletter, and suggestions for future content.

Please send any comments, queries or suggestions to catherine.robins@pinsentmasons.com

We tweet regularly on tax developments.

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